

JEI

A Two-Part Report: A and B

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Yen Sags Despite Official Efforts

Four years can be forever in currency markets. In September 1985 the world's five leading industrial powers began a concerted effort to drive down the value of the dollar while elevating that of the yen and other industrial country currencies. They committed record billions of dollars to the project and may have succeeded beyond their expectations. The realignment of currencies that resulted has been of historic proportions, with little chance of complete reversal.

But on the eve of the fourth anniversary of the September 22 Plaza Accord, as the Group of Seven industrial countries prepare to meet September 23 in Washington, the fervor for the Japanese currency has cooled considerably, a

victim of fickle currency traders and renewed interest by Japanese investors in the U.S. capital market, among other factors. In 1985 the central bankers succeeded in their efforts to light a fire under the Japanese currency, but in 1989 they have spent substantially larger amounts merely trying to keep it warm. Recent currency market responses have been chilly; the yen's mid-September level of Y145 to Y149 to the dollar is considerably lower than the average April value of Y132=\$1.00. The latest drops threaten to put the Japanese currency at its lowest level in more than two years.

Data released in early September indicate the extent of the battle waged by the industrial countries' central banks over the late spring and early summer to stabilize the value of the yen and other currencies against the dollar. For example, the Federal Reserve Bank of New York sold \$11.9 billion in dollars on foreign exchange markets between May and July in an attempt to increase the supply of dollars and thereby drive down the dollar's price against the yen and other currencies. By comparison, the Fed spent \$3.2 billion in support of the yen and other nondollar currencies between August and October 1985.

Similarly, the Bank of Japan reportedly sold \$20 billion in dollars in an effort that began immediately after an April 1989 G-7 meeting of finance ministers and central bankers. By comparison, BOJ had spent a reported \$3.3 billion in the three months following the Plaza Accord. As evidence of Tokyo's latest intervention, Japan's foreign reserves, which soared as BOJ acquired dollars in exchange for yen in an effort to stem the yen's rise in 1987 and 1988, have plummeted. By the end of August the reserves were down to \$88.3 billion, far below their \$100.4 billion peak in April, although still above their pre-1988 levels (see Table).

Japan's Foreign Exchange Reserves

(in billions of dollars at end of each period)

	<u>Level</u>	<u>Change From Previous Period</u>
1982	\$23,262	\$-5,141
1983	24,496	1,234
1984	26,313	1,817
1985	26,510	197
1986	42,239	15,729
1987	81,479	39,240
1988	97,662	16,183
1989		
January	98,177	515
February	98,830	653
March	99,353	523
April	100,361	1,008
May	95,694	-4,667
June	89,462	-6,232
July	88,865	-597
August	88,318	-547

Source: Ministry of Finance

In data released in early September, the New York Fed reported that trading in international currencies in New York came to \$128.9 billion a day as of April of this year. BOJ's data showed that currency transactions in Tokyo were \$115 billion every trading day. Added to the \$187 billion traded daily in London, worldwide transactions in the three largest currency markets totaled \$431 billion daily. (This total is overstated to the extent that it double counts trades between these currency centers.) Since the previous surveys in 1986, the Tokyo currency market grew slightly faster than those in the other market centers.

The figures indicate that international currency trading dwarfs other international financial activity. Currency transactions equal to a year's worth of Japanese exported goods are conducted in the Tokyo currency market every week, suggesting that the currency markets are far larger than what is needed to accommodate those trading goods and services. And, as the figures above imply, the actions of private currency traders in the spring of this year were hundreds of times larger than those of the central banks, even though that intervention was at record levels. Central bank actions appear to have been successful on several occasions since 1985, but only when the central bankers avoided going head-to-head with the currency traders. So, while the yen continues to get warm support from the central banks, the cold-shoulder treatment from the currency traders has prevented it from becoming the hot commodity it was four years ago.

Douglas Ostrom

JDA Remains Skeptical Of Glasnost

The Japan Defense Agency's annual report, approved by the cabinet September 12, reiterates the warning issued in last year's study that the Soviet military threat remains serious despite the Kremlin's efforts to reform domestic policies and pursue a more open dialogue with the West. The so-called defense white paper, the 15th in a series of reports issued since 1970, acknowledges that Soviet party leader Mikhail Gorbachev's domestic reforms, or perestroika, and new internationalist diplomacy, or glasnost, represents "the most daring and ambitious attempts in Soviet history."

However, JDA notes that Moscow's domestic reforms so far have not rehabilitated the Soviet economy in any significant way. Reviewing glasnost and Moscow's greater willingness to pursue arms control negotiations with Washington, the white paper emphasizes that the size of both conventional and nuclear military forces of the two superpowers remains massive. Thus, Japan must continue its self-defense buildup under the rubric of the U.S.-Japan Mutual Security Treaty, because it is imperative that "the Western nations . . . continue to make unified defense efforts in order to deter military conflicts and maintain world peace," JDA states.

Japanese defense planners' continued emphasis on the Soviet military threat comes as the 1986-1990 defense buildup plan draws to a close and as deliberations are about to begin on the next five-year defense plan. The substance and tone of the JDA report suggests that defense officials favor a continued, gradual expansion of Japan's defensive roles and missions in close cooperation with the United States. Given the current upheaval in Japanese politics, it will be interesting to see how strongly the defense bureaucracy